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FY 1989 OUTLOOK FOR THE JAPANESE ECONOMY

Summary

Japan enters 1989 feeling remarkably optimistic about its economy. Domestically led demand continues to propel the economy forward, and the only real question seems to be at what rate will growth continue. On top of 5.2 percent inflation-adjusted growth in fiscal 1987, which ended March 31, 1988, and an expected 4.9 percent increase this fiscal year, Tokyo expects the economy to grow at a 4 percent clip in FY 1989, which begins April 1.

The government has few doubters in the private sector. In fact, many believe Tokyo is too pessimistic with its fiscal projections. However, in recent years, government and private forecasters almost always have varied from the eventual result in the same direction, suggesting both may be either too pessimistic or too optimistic. One source of surprise could be foreign demand, which has been relegated to virtual irrelevance in most forecasts.

The Economy in FY 1988

A year ago the focus was on the yen. The Japanese currency earlier had begun a sustained rise that, as the fiscal year began last April, showed few signs of slowing significantly. While the effect on the economy to that time had been less than expected, few felt confident that the fallout from the exchange rate realignments could be avoided indefinitely, especially, if, as some analysts suggested, the 100-yen dollar arrived by the end of FY 1988. It was as if the Japanese economy had sailed into uncharted waters that many feared were initially deceptively placid. A year later the waters have been charted, and most analysts are convinced that the feared storms are nowhere in sight. In fact, experts talk more and more about the merits of the yen's appreciation.

In many ways FY 1988 has been a year of consolidation with few surprises. The currency market has stabilized with the yen close to its level of a year ago; the landmark 100-yen level seems further away than it did last year at this time. Black Monday in October 1987, which some feared could cause a downturn, particularly in the United States, is practically forgotten, especially in Tokyo, where the stock market repeatedly has set new records. While a year ago some analysts were worrying about the effects on demand in Japan of a massive wipeout of equity resulting from the October 1987 crash, a year later they are adding up the consequences of additional wealth on economic growth.

Internal developments proved even more favorable than external ones. Japanese firms confounded fears that they would be wary about investing in the domestic economy in light of the unsettling FY 1987 developments. Threatened by what were expected to be declining markets abroad for traditional exports, manufacturers increased capital spending to deal with the imperatives of supplying those markets with new products and in unaccustomed ways, including offshore production. Research and development expenditures went up for the same reason. Firms also retooled some of their capacity to meet a hoped-for pickup in domestic demand that would replace any loss of foreign markets. The year-to-year double-digit increase in spending for plant and equipment altered, more than expanded, productive capacity but became a significant source of aggregate income and, indirectly, a source of consumer demand as well.

In addition, firms and individuals discovered a terms-of-trade benefit from the yen's appreciation: falling import prices, which implied that a given volume of exports fetched more imports. While the actual drop in import prices at the consumer level was modest -- and very inadequate, according to some foreign and domestic critics -- consumers also benefited from a wider availability and a larger selection of products. The benefits of lower import prices spilled over to the whole economy as consumers and firms used some of their savings on imports to increase spending generally.

Kazuaki Harada, chief economist of Sanwa Bank, Ltd., sees a connection between the investment boom and the cheap yen. He argues that the yen's appreciation led to a drop in the cost of capital goods relative to the price of items produced with them. For example, widget-producing machinery may have dropped more than the price of widgets, making it worthwhile to buy the machinery. Since this experience was repeated in industry after industry, aggregate investment increased.

A year ago the government of Japan expected to play at most a small role in overall FY 1988 economic growth in contrast to its more activist participation in FY 1987. It has largely stuck to this course. The original projection of a 1.7 percent real rise in FY 1988 government spending has been revised to a 2.3 percent increase, still well below the estimated 4.9 percent growth rate of the economy overall. With government expenditures rising in line with expectations and overall growth higher than expected, the result has been smaller than anticipated government demand on the capital markets, helping to keep interest rates relatively low. Initially, Tokyo planned for 15.6 percent of the FY 1988 general account budget to be financed with bonds; it now puts this figure at

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12.9 percent. Interest-sensitive sectors, such as plant and equipment investment and private residential construction, have benefited, one reason why both are now more robust than was expected a year ago.

Low interest rates in Japan, strong demand in the United States and elsewhere and a comparatively stable yen all have interacted to keep exports higher and the current account surplus larger than expected. However, since exports have grown in volume less than imports, the external sector has been a drag on the economy for the third straight year. This means that domestic demand has had to be even stronger to accommodate the rising volume of imports.

Consumer spending, the largest component of gross national product, has expanded impressively during FY 1988, getting a substantial boost from strong demand elsewhere in the economy. Consumers with substantial stock or land holdings boosted their spending as the value of their property went up. For others, real wage hikes averaging more than 3 percent permitted expenditures to rise by about the same percentage. For the fiscal year consumer spending is likely to match the overall growth in GNP.

On balance these factors are likely to boost the growth rate for the year much higher than initially expected. For the fiscal year that began last April 1, the government originally anticipated a 3.8 percent inflation-adjusted expansion in GNP. With two quarters of GNP figures not yet released, the government now estimates that growth will average 4.9 percent. Even this estimate may be too pessimistic; few private analysts expect growth to be less than 5 percent. Assuming that growth in the September-December 1988 period was in line with previously released data and even hypothesizing zero growth in the January-March 1989 quarter, the FY 1988 outcome would reach about 5.2 percent, matching the FY 1987 rate.

Tokyo was closer to the mark in its outlook for the external sector than for the economy as a whole. In line with government assumptions, the yen has varied little from the level that prevailed at the time of the forecast last year. But, primarily because exports were larger than expected, the government now feels it was too optimistic in expecting a decline in the current account surplus to $72 billion from the $84.5 billion level of FY 1987. It now estimates that the FY 1988 surplus will be about $78 billion. Many economists outside the government believe Tokyo is still too optimistic; they estimate the current account will end up about $80 billion in surplus.

Japan's economic performance has been equally sparkling in comparison with that of its major trading partners. The United States, for example, gave analysts a pleasant surprise by recording 3.8 percent growth in calendar 1988, but Japan's GNP almost certainly grew faster, with most estimates between 5.4 percent and 6 percent for the calendar year. The Organization for Economic Cooperation and Development calculates that Japan's economy grew a real 5.75 percent in 1988, a rate that ranks first among the seven largest OECD countries and second only to Turkey among all 24 member nations.

Factors to Watch in FY 1989

Investment Demand - The most volatile component of GNP, private plant and equipment spending, makes up a substantial part of Japan's economy, coming to 21.4 percent of the total in the most recent GNP figures. It also will be important in the coming year to the extent that new investment leads to greater capacity that can prevent bottlenecks from slowing the economy's growth.

Surging domestic investment, if it continues, will affect the balance of payments because it will compete for capital with overseas borrowers. Unless domestic or foreign monetary officials intervene, the capital outflow will shrink and the current account surplus decline. Analysts at NRI & NCC Co., Ltd. believe that higher domestic investment was a significant factor in the drop in Japan's current account surplus through late 1988. Over the longer term, however, investment that enlarges the capacity of the economy results in a larger domestic savings flow, which could lead to a bigger surplus.

Recent data and surveys suggest that plant and equipment investment is likely to become even stronger, at least over the next few months. Orders from the private sector for machinery (except for ships and orders from the electric utility industry) soared 27.6 percent in November and 29.8 percent in December over year-earlier levels. Since analysts consider this statistic a good predictor of plant and equipment investment over the next half year, the outlook for investment in the first few months of FY 1989 is very positive.

Other surveys point to a similar conclusion. An Economic Planning Agency survey of 4,082 large firms finds them planning to hike investment spending substantially in the first six months of calendar 1989, which includes the first quarter of FY 1989. Its survey shows that the seasonally adjusted increase over the last six months of calendar 1988 comes to 8 percent with manufacturing leading the way with a 14.6 jump. Furthermore, the EPA survey finds, 15 percent of all firms judged their plant and equipment to be inadequate as of the last quarter of calendar 1988; a year earlier only 7 percent did. Conversely, those who felt they had excess capacity dropped from 15 percent in the last quarter of calendar 1987 to 10 percent in October-December 1988. These figures could mean that businesses are more serious about adding capacity -- in contrast to modifying existing plant and equipment -- than they have been in the past year.

Housing - In FY 1987 outlays for housing soared 25.6 percent after adjustment for price increases and were a major factor in getting the Japanese economy out of the high-yen doldrums. In FY 1988, as expected, housing expansion has slowed considerably. In the July-September 1988 period, the latest available statistics, spending for housing increased at a seasonally adjusted real 6.1 percent rate after dropping the previous quarter.

Some analysts point to housing as a prop under overall consumer demand. The theory, borrowed from analyses of the U.S. economy, is that new homeowners make significant purchases of consumer durables, such as furniture and large appliances, on moving into a new home. If true, Japan's economy could still be riding the waves of earlier double-digit surges in housing starts, but with fewer new houses in the pipeline this positive effect could be petering out. Others do not buy this argument, suggesting that Japanese houses, which are smaller and furnished differently than American homes, do not have the same effect in pulling up aggregate consumer demand.

Complicating the picture further is the difficulty of predicting which way housing starts will go. Analyses by NRI & NCC suggest that rising land prices, contrary to intuition, have stimulated housing starts in Japan. Reasoning that potential homeowners expect prices to keep rising, the analysts figure there is motivation to act earlier rather than later, especially since quicker action gives buyers the expectation of capital gains on their property. Rental

housing construction starts also get a boost, according to NRI & NCC, because they are a good shelter from higher taxes, which are another result of higher land prices.

Of course, escalated land values have the potential to price houses out of the reach of would-be buyers. The combination of high but stable land prices could be deadly for housing demand. Potential buyers would have the burden of purchasing at a higher cost without the compensation of an expected capital gain.

Just such a result could be in the offing. Recent surveys suggest that land prices still are rising in Japan generally, although they are leveling off in Tokyo (see JEI Report No. 6B, February 10, 1989). If, as some suggest, rising prices elsewhere are little more than a ripple effect of the soaring prices in Tokyo during 1987, land prices could be about to stabilize nationwide at a much higher level than a few years ago, leading to the conclusion of fewer housing starts.

Housing shares a characteristic with plant and equipment that is potentially troubling. Both are long-lived assets. As interest rates or purchase costs fall, reducing the cost of owning either kind of asset, home buyers and firms increase their holdings to some optimal level. But costs need to keep falling to push this optimal level higher and to keep investment demand strong. Without this backdrop the stage is set for a dramatic decline in investments in new plant and equipment and in housing once pent-up demand is met.

Housing as well as plant and equipment investments grew slowly in the early 1980s, suggesting they were ready to boom once costs dropped. The 1987-88 pattern may represent catch-up demand that could be close to being satisfied, absent further drops in interest rates or other costs that would lead to an additional spurt.

Fiscal Policies and Tax Changes - Late in 1988 the Diet approved a sweeping tax reform proposal. In broad terms the reforms substitute a uniform 3 percent consumption tax for a wide variety of commodity taxes and for a small portion of income taxes. On balance the government calculates that the program nets out as a modest tax reduction of Y2.6 trillion ($20.8 billion at Y125=$1.00) in FY 1989, which should stimulate economic growth slightly between FY 1990 and FY 1993 (see JEI Report No. 3B, January 20, 1989). Depending on how much of the tax is passed through, NRI & NCC puts this effect at between 0.3 and 0.5 percentage point of GNP in FY 1989, on top of a 0.1 percentage point boost in FY 1988. Sumitomo Bank, Ltd. estimates the FY 1988 impact at 0.1 point of GNP and the FY 1989 effect at 0.2 point.

More significant than the macroeconomic impact may be the way the new tax affects individual economic decisions. Taxes on many big-ticket items will fall; those on other purchases may rise. In addition, since consumers became aware of the pending changes in early January, three months ahead of implementation, they appear to be timing their purchases to minimize the tax impact. Car sales dropped 2.9 percent in January 1989 over the same period a year earlier apparently because consumers were waiting for the coming cut in taxes on big cars. Clearly, if the car example is replicated elsewhere, manufacturers will have to scramble to get their production schedules and inventories properly adjusted.

The reforms also are expected to boost imports since many foreign products are the luxury items scheduled for big cuts. Tokyo puts the reduction in the current account surplus at a remarkable $5 billion annually, suggesting approximately a 6 percent decline from this cause alone.

Of course, for every item falling in price, several are expected to rise as a result of the new 3 percent tax. How much of the tax increase retailers will pass on is uncertain; the government's best guess is that consumer prices will jump an extra 1.1 percentage points in FY 1989 because of the tax changes. A February 1989 survey by the daily Nihon Keizai Shimbun of 10 major economic forecasters found that on average they were in agreement with the government, with the estimated tax impact on consumer prices ranging from 0.6 point set by Mitsui Bank, Ltd. to 1.5 points forecast by Mitsubishi Research Institute.

Apart from the tax reform, government policies should have little effect on the economy. The pending FY 1989 general account budget calls for a 6.6 percent aggregate spending increase over the initial FY 1988 level. The Fiscal Investment and Loan Program, which is financed largely by postal savings deposits, shows an even larger jump of 9 percent (see JEI Report No. 5B, February 3, 1989). But revenues will rise even faster, curtailing the reliance on government borrowing and reducing the fiscal stimulus that otherwise would result from such spending increases. To the extent it is successful, the government's fiscal stance will free up more savings for domestic private investment and overseas capital flows. Put differently, the effect of a smaller Japanese budget deficit is to reduce real interest rates, which makes borrowing more attractive for both Japanese and overseas investors.

Consumer Spending - Although cast in the role of heroes for saving Japan's economy from the ravages of currency appreciation, Japanese consumers actually have responded relatively passively during most of the past two years to increases in income that originated elsewhere in the economy. In all of FY 1987 and in FY 1988 through the latest available quarter, consumer spending increases have lagged slightly behind the growth of the economy as a whole.

Part of the explanation is that the economy -- and consumer spending -- grew faster than anticipated. With much higher incomes than expected it is no surprise that consumer spending went up significantly, even if the increase was not as great as in the rest of the economy. The result of relatively sluggish consumer spending has been that personal savings have been larger than expected, both in absolute terms and as a percentage of the economy. The swelling supply of savings, even though it has been accompanied by a rapid increase in investment demand, has complicated the task of reducing the flow of capital overseas and its mirror image, the current account imbalance.

External Demand - With all the excitement about domestic-led growth, one easily forgets how dependent Japan is on overseas economies, particularly that of the United States. While exports are less important than a few years ago and the share of Japanese exports going to the United States dropped to 33.8 percent in calendar 1988 after peaking in 1986 at 38.5 percent, the American market remains extremely important to Japan. Many economists typically assign the U.S. economic growth rate a prominent place among the variables affecting the Japanese economy. For example, Professor Heizo Takenaka of Osaka University argues that a 2 percentage point decline in U.S. GNP would lead to a 1 percentage point drop in Japanese GNP.

In the coming year, the influence of American demand may be asymmetrical, potentially stronger on the downside than on the upside. As their economy approaches full employment, Japanese exporters would have difficulty accommodating faster than expected growth in the United States. In other words, the increase in export shipments would be limited because the economy would have little room to expand to meet the hypothetical increase in aggregate demand. In this situation real GNP in Japan would be little affected. Slower than expected growth in the United States -- without compensating increases elsewhere in Japan or abroad for Japanese firms -- could lead to declining demand, fewer shipments to the United States, and a drop from the baseline rate of GNP growth on the order suggested by Professor Takenaka.

The Government's Outlook

Delayed by the acrimonious debate over tax reform, the government was slow this year in developing its FY 1989 economic outlook, which was released in late January rather than in late December. The government's figures are presented in Tables 1-3. Tokyo settled on a 4 percent real GNP growth rate for the coming year, down somewhat from the 4.9 percent it is now expecting for FY 1988. Even so, the government is more optimistic about the coming year than it was at the same point a year ago, when it expected 3.8 growth in FY 1988.

Tokyo clearly sees the economy evolving into a new phase, with consumer spending accounting for an increasing share of the momentum, rising a real 4.6 percent, substantially above the overall growth rate. Private plant and equipment investment still is expected to be important, although the rate of growth will slow some from the current fiscal year. Housing will remain in the doldrums. The projections suggest that external demand will pull down economic growth for the fourth straight year, and government purchases of goods and services will rise only modestly, contributing little to economic growth (see Table 4).

Other Forecasts

Private forecasters have been even further off than the government in their predictions of economic growth during fiscal 1988. On average they bet a year ago that growth would come in at 3.6 percent. As a measure of their own inaccuracy, they are now saying that growth will be closer to 5 percent (see Table 5).

For the second year in a row, the most optimistic preliminary forecast so far has proved the most accurate. This time the winner is Kangyo Kakumaru Research Institute, whose original forecast of 4.4 percent real growth for FY 1988 is likely to be at least half a percentage point too pessimistic. The Research Institute of the National Economy finishes second with an initial forecast of 4.3 percent growth after coming out on top the previous year. However, two years ago this ever-optimistic organization had the second worst record because, although nearly all groups overestimated growth, it did so by the widest margin. In short, FY 1987 and FY 1988 forecasts all were too low and FY 1986 forecasts were almost as inaccurate in the other direction. In each instance the initial government outlook varied from the actual or then expected outcome in the same direction as the overwhelming majority of private forecasters.

Generally, private forecasters are a little more optimistic concerning FY 1989 than Tokyo, expecting on average that growth will be about 4.3 percent during the coming year. The Research Institute on the National Economy,

Table 1: Government's FY 1989 Economic Outlook: Real Gross National Product

(percent change)

	Actual			Estimated	Projected
	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Real Gross National Product	4.5%	2.7%	5.2%	4.9%	4.0%
Consumer Spending	2.8	3.4	4.5	4.9	4.6
Residential Construction	2.8	11.0	25.6	2.1	-3.3
Private Capital Spending	13.2	4.3	10.0	15.9	9.2
Government Spending	-1.7	7.7	2.2	2.3	1.3

Table 2: Other Indicators

(percent change unless otherwise indicated)

	Actual			Estimated	Projected
	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Industrial Production	2.5%	-0.2%	5.8%	8.4%	5.5%
Wholesale Prices	-3.3	-9.4	-2.0	-0.8	0.9
Consumer Prices	1.9	0.0	0.5	0.7	2.0
Unemployed (in thousands)	1,580	1,710	1,700	1,550	1,500

Table 3: Japan's Balance of Payments

	Actual			Estimated	Projected
	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
Dollars (billions)					
Current Account Surplus	$55.0	$94.1	$84.5	$78.0	$71.1
Trade Surplus	61.6	101.6	94.0	93.0	88.0
Yen (trillions)					
Current Account Surplus	Y12.1	Y15.1	Y11.7	Y9.9	Y8.7
Trade Surplus	13.5	16.2	13.0	11.8	10.9
Exports	39.8	33.8	32.2	33.6	35.7
Imports	26.2	17.5	19.2	21.8	24.8

Table 4: Components of Japan's Real Economic Growth

	Total Rate	Domestic		External Component
		Private	Public	
FY 1981	3.3%	1.5%	0.5%	1.2%
FY 1982	3.2	2.6	0.1	0.5
FY 1983	3.7	1.9	0.2	1.5
FY 1984	5.1	3.7	0.2	1.3
FY 1985	4.5	4.0	-0.3	0.8
FY 1986	2.7	2.8	1.3	-1.4
FY 1987	5.2	5.8	0.4	-1.0
FY 1988*	4.9	6.2	0.4	-1.6
FY 1989**	4.0	4.5	0.2	-0.7

*Calculated from government growth estimate.
**Calculated from government outlook.

which forecasts growth at 5 percent, is as upbeat as ever but not as confident as Sumitomo Trust & Banking Co., Ltd., which expects GNP to rise 5.1 percent in inflation-adjusted terms. The most pessimistic organization is Nippon Credit Bank, Ltd., which says growth will be only 3.4 percent in FY 1989.

The forecasts are almost unanimous in estimating that consumer spending will outpace GNP growth; only eight organizations out of 40 believe the opposite. Where they differ is on plant and equipment spending, for which Sumitomo Trust has the most optimistic forecast, 15.7 percent. The bank's estimate is hardly surprising considering it also has the highest GNP forecast. Conversely, Tokai Bank, Ltd. has the second-lowest guess concerning GNP and is the least optimistic about plant and equipment spending, coming in at only 5.8 percent. Clearly, much of the variation in the GNP estimates depends on differing views about investment spending.

Other factors appear to matter far less. Guesses as to the U.S. growth rate range between 2.3 and 3 percent, but this variation does not seem to matter. Those more optimistic about the United States are no more likely to predict high growth rates for the Japanese economy. Similarly, exchange rate and export projections have little influence on the GNP forecasts. In short, the forecasts lend some credence to -- if not persuasive evidence for -- the argument regarding the asymmetric influence of the U.S. and other foreign economies described earlier. The close to full-employment level of the Japanese economy would seem to imply that increased external demand could be met only at the cost of lesser demand elsewhere in the economy, with no effect on GNP overall. Unexpectedly low growth abroad, however, could have a negative impact.

In recent years both government and private forecasters as a group have overestimated about as often as they have underestimated economic growth. The close grouping of the forecasts around the average, however, has led the actual results to often lay outside the range of forecasts. FY 1989 could repeat this pattern; growth easily could surpass 5.1 percent, the most optimistic forecast, or sink under 3.4 percent, the least optimistic.

Fiscal year 1989 could be full of surprises capable of propelling the economy far in one direction or the other. Here is a sampling:

Table 5: Summary of Private Forecasts for FY 1989

(percent change unless otherwise indicated)

Banks	Real GNP: Revised FY 1988	Real GNP: Initial FY 1989	Real Consumer Spending	Real Capital Spending	Consumer Prices	Current Account Surplus*	Y/$ Exchange Rate	Oil Prices ($/barrel)
Sumitomo Trust & Banking Co., Ltd.	5.2%	5.1%	4.8%	15.7%	0.5%	$71.8	Y129.3	$14.6
Bank of Tokyo, Ltd.	5.3	4.6	4.6	10.5	1.2	77.9	122.5	n.a.
Fuji Bank, Ltd.	5.1	4.6	5.5	9.2	1.2	72.0	115.0	14.0
Mitsubishi Trust & Banking Corp.	5.1	4.6	5.0	11.4	1.8	64.1	116.0	15.0
Saitama Bank, Ltd.	5.2	4.5	4.7	9.8	1.5	78.4	118.0	14.8
Taiyo Kobe Bank, Ltd.	5.3	4.5	4.3	9.2	1.1	74.4	117.0	15.5
Industrial Bank of Japan, Ltd.	5.7	4.4	4.8	11.1	2.5	73.8	120.0	14.5
Yasuda Trust & Banking Co., Ltd.	5.0	4.4	4.8	9.9	2.2	79.7	118.0	15.0
Dai-Ichi Kangyo Bank, Ltd.	5.2	4.3	4.7	10.5	2.1	69.4	115.0	13.0
Daiwa Bank, Ltd.	5.0	4.3	4.2	10.0	1.7	76.7	117.0	14.5
Mitsubishi Bank, Ltd.	5.1	4.3	4.2	9.2	2.2	80.0	120.0	14.0
Toyo Trust & Banking Co., Ltd.	5.1	4.1	4.2	9.1	2.2	86.2	115.0	14.0
Bank of Yokohama, Ltd.	4.8	4.0	5.0	8.5	0.3	82.4	113.8	14.0
Chuo Trust & Banking Co., Ltd.	4.8	4.0	3.6	8.2	0.9	65.8	123.2	16.0
Hokkaido Takushoku Bank, Ltd.	4.8	4.0	4.3	9.1	1.0	75.2	120.3	14.3
Mitsui Bank, Ltd.	4.9	3.9	4.0	8.4	1.5	68.5	121.9	16.1
Mitsui Trust & Banking Co., Ltd.	5.1	3.9	4.2	8.9	1.0	75.4	115.0	n.a.
Sumitomo Bank, Ltd.	4.8	3.8	4.4	8.8	1.6	71.0	120.0	13.5
Tokai Bank, Ltd.	5.2	3.5	5.0	5.8	1.0	65.0	110.0	n.a.
Nippon Credit Bank, Ltd.	4.8	3.4	4.5	6.9	2.9	72.9	120.0	14.8
Insurance Companies								
Asahi Mutual Life Insurance Co.	5.0	4.7	4.5	10.6	1.1	73.0	121.3	14.7
Sumitomo Life Insurance Co.	5.1	4.5	4.5	10.3	2.1	77.5	118.0	15.0
Tokio Marine & Fire Insurance Co., Ltd.	5.1	4.5	4.4	9.3	1.2	75.0	120.0	15.0
Dai-Ichi Mutual Life Insurance Co.	5.1	4.3	4.0	8.5	2.3	70.0	119.0	n.a.
Meiji Mutual Life Insurance Co.	5.1	4.2	4.5	8.6	1.8	76.5	117.4	15.8
Trading Companies								
Marubeni Corp.	5.3	4.5	4.8	10.4	2.6	79.9	120.0	15.0
Sumitomo Corp.	5.2	4.5	4.8	10.0	1.5	78.0	117.0	n.a.
Mitsubishi Corp.	5.2	4.4	4.6	10.6	1.8	74.0	120.0	15.5
Research Organizations								
Daiwa Securities Research Institute	5.1	5.0	5.2	8.7	0.6	68.8	123.3	13.3
Research Institute of the National Economy	5.3	5.0	5.0	11.5	2.0	70.3	117.3	16.0
Kangyo Kakumaru Research Institute	5.0	4.8	5.0	10.3	1.0	75.1	120.0	14.5
Kansai Economic Research Center	4.9	4.7	5.0	10.5	1.8	78.7	116.8	n.a.
NRI & NCC Co., Ltd.	5.0	4.6	5.0	10.5	1.2	73.3	120.0	14.0
Sanyo Investment Research	5.4	4.6	5.2	10.8	1.3	72.0	118.0	13.2
Cosmo Research Center	5.2	4.5	4.7	9.4	2.0	71.9	120.8	14.4
Okasan Economic Research Institute	5.1	4.5	4.9	10.0	2.1	76.1	118.0	14.0
Nikko Research Center	5.1	4.4	4.8	10.3	1.0	75.1	120.0	14.5
Japan Economic Research Center	4.7	4.3	4.8	10.1	2.1	84.0	114.0	n.a.
Mitsubishi Research Institute	5.1	4.1	4.0	8.6	0.9	73.3	117.0	15.7
Yamaichi Research Institute	5.0	3.7	3.8	12.6	2.0	82.0	117.0	13.1
Average Forecast	5.1	4.3	4.6	9.8	1.6	75.6	118.4	14.6

*In billions of dollars.

Source: Toyo Keizai, Tokei Geppo

• The super-optimistic scenario - If, in fact, the U.S. economy grows somewhat faster than experts predict, one result will be growing demand for Japanese exports. With new capacity in Japan possibly coming on-line faster than the government or private forecasters expect, this demand might be met rather easily. The rapid growth of plant and investment spending also will lead directly to increased domestic demand, pulling the whole economy to a higher level than the forecasters predict. This scenario would amount to a rerun of what has happened this year.

• The neutral but different scenario - For Japanese firms faster than expected foreign growth could be a fortunate development if domestic consumers do not play the role Japanese observers expect. In short, the Japanese economy will get a little help from abroad, enabling it to at least meet GNP growth projections once again, albeit in a different way than suggested by the government's and private organizations' numbers.

• The pessimistic scenario - In this scenario the yen-dollar exchange rate assumes more importance. In the United States and elsewhere policy adjustments could reduce real interest rates outside Japan, thus making the yen stronger and short-circuiting the hypothesized increase in demand for Japanese exports. And, if yen appreciation is coupled with a less than expected pickup in domestic demand, the projections could end up being too optimistic.

• The stock-adjustment scenario - One-shot adjustments to lower interest rates drove, in part, the housing boom and the flood of plant and equipment investment, with the latter also spurred on by new demand patterns and competition with rival firms. Once companies realize this -- aided in their understanding by looming extra capacity -- they may scale back their plans dramatically, thereby removing one of the locomotives pulling Japanese economic expansion. Therefore, GNP growth could stall, other factors being equal.

Conclusion

If recent history is any guide, the one certainty is that the future will be different than predicted. The Japanese economy seems to have the wind at its back. Strong foreign demand and surging investment demand, coupled with an accommodating Japanese consumer, could push growth even above the published guesses. But storms are equally possible in the new seas into which Japan has sailed. Professor Takenaka of Osaka University believes that export demand does not yet fully reflect the negative effects of past yen appreciation, while capital spending increases are a result of anticipated exchange rate changes. As a result, Japan is receiving all the normal benefits -- and then some -- of the strong yen without yet having to bear the full costs. In addition, he says, demand is being held up by an unsustainable increase in asset prices. If he is right, the Japanese economy could be in the lull before the storm. Everyone, including Americans on the other side of the shrinking Pacific, will have to just wait and see.

For further information, contact Douglas Ostrom.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

APPENDIX

Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1986	FY 1987	October-December 1987	January-March 1988	April-June 1988	July-September 1988
Gross National Product	Y301,833.8 (2.7%)	Y317,589.4 (5.2%)	Y319,940.4 (7.1%)	Y327,750.6 (10.1%)	Y324,982.8 (-3.3%)	Y332,284.6 (9.3%)
Personal Consumption Spending	168,933.2 (3.4%)	176,575.8 (4.5%)	176,966.2 (3.8%)	180,839.0 (9.0%)	182,010.8 (2.6%)	184,581.3 (5.8%)
Private Residential Construction	15,634.1 (11.0%)	19,631.1 (25.6%)	21,144.4 (55.1%)	21,541.1 (7.7%)	19,632.3 (-30.3%)	20,874.8 (26.5%)
Private Fixed Nonresidential Investment	56,213.6 (4.3%)	61,812.5 (10.0%)	62,602.3 (15.7%)	65,130.8 (17.2%)	68,143.0 (19.8%)	71,116.1 (18.6%)
Change in Business Inventories	1,024.4 (*)	1,274.0 (*)	1,667.2 (*)	1,438.7 (*)	2,043.0 (*)	1,799.1 (*)
Government Current Expenditures	28,882.7 (6.3%)	28,637.2 (-0.9%)	28,570.8 (0.7%)	28,835.0 (3.8%)	28,990.9 (2.2%)	29,175.9 (2.6%)
Government Fixed Investment	22,247.0 (7.0%)	24,466.8 (10.0%)	24,825.7 (24.2%)	25,809.5 (16.8%)	25,189.5 (-9.3%)	24,735.9 (-7.0%)
Change in Government Inventories	856.4 (*)	45.3 (*)	-185.2 (*)	415.9 (*)	119.5 (*)	-225.9 (*)
Net External Sector	8,042.4 (-34.5%)	5,146.7 (-36.0%)	4,349.0 (-83.5%)	3,740.6 (-45.3%)	-1,196.2 (-99.0%)	227.4 (*)
Exports of Goods and Services and Factor Income Received	52,692.8 (-3.6%)	55,415.8 (5.2%)	55,666.1 (-1.4%)	57,573.7 (14.4%)	55,377.6 (-14.4%)	60,372.4 (41.3%)
Imports of Goods and Services and Factor Income Paid	44,650.5 (5.4%)	50,269.1 (12.6%)	51,317.1 (19.9%)	53,833.1 (21.1%)	56,573.8 (22.0%)	60,145.0 (27.7%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency